Policy on Transfers From Earnings Reserve to the Permanent Fund

Report to the State Board of Land Commissioners
by the:
Endowment Fund Investment Board
Endowment Reform Review Task Force
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11/27 DRAFT – Subject to revision after 11/29 Task Force meeting

Summary

- At its August 2006 meeting, the Land Board asked the Task Force and the EFIB to determine the advisability of transferring Earnings Reserve to the Permanent Fund
- Based on work done since then, the two groups recommend that no transfer be made to Earnings Reserves at this time
- Also examining the overall Spending Policy, but no recommendation is ready yet

Background

- The Task Force and the EFIB have been examining Spending Policy in light of recent and expected future improvements in reserves
  – When should a change be made to the current policy to reflect the long term earnings potential of the endowments of $80-$90 million per year vs. today's distributions of $38 million?
- Related questions:
  – How much is needed in reserves to minimize the chances of having a future reduction in distributions?
  – When should a transfer be made from Earnings Reserves to the Permanent Fund?

How High Should Reserves Be?

- The size of reserves is primarily a function of expected future volatility of fund returns and land revenues
- The Task Force and the EFIB are still examining data and modeling outcomes, but current work implies at least 2 ½ years of distributions should be in reserve for Public Schools.
  - For many of the small endowments, the required reserves are much higher

Current Situation vs. Long-term Target

- As of the end of FY2006, reserves totaled almost $100 million, providing significant coverage of the $38 million annual distribution
  - No endowment has less than 175% coverage and one has over 800%
- However, to comfortably distribute expected long-term endowment earnings of $80-$90 million per year would require reserves of $250 million, 2 ½ times what is available now
  - No endowment has 100% of what is needed to cover its long-term distribution goal or target

Coverage Info By Endowment

(dollar amounts in millions)

	Distributions		**Earnings Reserves**			**Minimum Required**
	Current*	***Target***	***FY2006*****	***% of Current***	***% of Target***	***Coverage******
Public Schools	27.0	55.8	64.9	241%	116%	250%
Ag College	0.7	2.5	2.4	337%	98%	480%
Charitable Institutions	2.6	5.4	6.1	238%	114%	270%
Normal School	2.3	6.4	5.4	235%	85%	250%
Penitentiary	0.7	2.0	1.3	176%	63%	410%
School of Science	2.1	7.4	3.9	181%	52%	340%
State Hospital South	1.1	6.1	9.2	803%	151%	280%
University	2.0	6.2	6.2	311%	100%	350%
Total	38.6	91.8	99.5	258%	39%	277%

Note: "Target" distributions and reserves are based on the assumption that a 200% safety margin is required in Earnings Reserves, plus normal annual variation in lands revenues

* Approved distributions for FY2008

** Audited June 2006 balance plus estimated $8 million of transfers of dedicated funds

*** Based on expected volatility of financial markets and land revenues

Coverage at targeted levels of distributions does not exceed the minimum required

Conclusion

- Currently, the endowments do not have enough reserves to support their expected long-term level of distributions
- Therefore, both the Task Force and the EFIB recommend that there be no transfers from Earnings Reserve to the Permanent fund for any endowment at this time